Senate Bill No. 1233

CHAPTER 612

An act to amend Sections 17054, 17062, 17152, 17273, 18510, 19184, and 23802 of, and to add Sections 17085.8, 17210.6, 17507.4, 17507.6, 18037.6, and 23712 to, the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

[Approved by Governor October 1, 1997. Filed
with Secretary of State October 3, 1997.]

LEGISLATIVE COUNSEL'S DIGEST

SB 1233, Lockyer. Income and bank and corporation taxes.

The Personal Income Tax Law authorizes various credits against the taxes imposed by that law, including a credit of $67 for taxable years beginning in 1996, and adjusted for inflation thereafter, as specified, for each dependent.

This bill would instead authorize a credit of $120 against those taxes for each taxable year beginning on or after January 1, 1998, and before January 1, 1999, and a credit of $222 for each taxable year beginning on or after January 1, 1999, adjusted for inflation thereafter, as specified, for each of those dependents.

The Personal Income Tax Law provides for the manner in which taxable gains are to be recognized upon the disposition of property, including real property that is the principal residence of the taxpayer.

This bill would, as provided, conform these provisions, with respect to the recognition of gain upon the disposition of a principal residence, to recent changes in federal income tax law.

Under the Personal Income Tax Law and the Bank and Corporation Tax Law, various provisions of the federal Internal Revenue Code as enacted as of a specified date are referenced in various sections of the Revenue and Taxation Code.

This bill would also make certain recent changes in federal income tax laws applicable, with specified exceptions and modifications, for purposes of the Personal Income Tax Law, with respect to individual retirement accounts, including the use of retirement funds for higher education expenses, for acquisition of a personal residence by a first-time homebuyer, as specified, and health insurance of self-employed individuals.

This bill would also, for purposes of the Bank and Corporation Tax Law, make nonsubstantive, technical changes to provisions pertaining to ‘‘S corporations.’’

This bill would incorporate additional changes in Sections 17054 and 17062 of the Revenue and Taxation Code proposed by SB 455, to be operative only if SB 455 and this bill are both enacted and become effective as specified, and this bill is enacted last. This bill would incorporate additional changes in Section 17152 of the Revenue and Taxation Code proposed by SB 5, to be operative only if SB 5 and this bill are both enacted and become effective as specified, and this bill is enacted last.

This bill would take effect immediately as a tax levy.

The people of the State of California do enact as follows:

SECTION 1. Section 17054 of the Revenue and Taxation Code is amended to read:

17054. In the case of individuals, the following credits for personal exemption may be deducted from the tax imposed under Section 17041 or 17048, less any increases imposed under paragraph (1) of subdivision (d) or paragraph (1) of subdivision (e), or both, of Section 17560.

(a) In the case of a single individual, a head of household, or a married individual making a separate return, a credit of fifty-one dollars ($51) for taxable years beginning on or after January 1, 1987, and before January 1, 1988, and fifty-two dollars ($52) for taxable years beginning on or after January 1, 1988.

(b) In the case of a surviving spouse (as defined in Section 17046), or a husband and wife making a joint return, a credit of one hundred two dollars ($102) for taxable years beginning on or after January 1, 1987, and before January 1, 1988, and one hundred four dollars ($104) for taxable years beginning on or after January 1, 1988. If one spouse was a resident for the entire taxable year and the other spouse was a nonresident for all or any portion of the taxable year, the personal exemption shall be divided equally.

(c) In addition to any other credit provided in this section, in the case of an individual who is 65 years of age or over by the end of the taxable year a credit of fifty-one dollars ($51) for taxable years beginning on or after January 1, 1987, and before January 1, 1988, and fifty-two dollars ($52) for taxable years beginning on or after January 1, 1988.

(d) A credit of fifty-one dollars ($51) for taxable years beginning on or after January 1, 1987, and before January 1, 1988, fifty-two dollars ($52) for taxable years beginning on or after January 1, 1988, and before January 1, 1998, one hundred twenty dollars ($120) for taxable years beginning on or after January 1, 1998, and before January 1, 1999, and two hundred twenty-two dollars ($222) for taxable years beginning on or after January 1, 1999, for each dependent (as defined in Section 17056) for whom an exemption is allowable under Section 151(c) of the Internal Revenue Code (relating to additional exemption for dependents). The increased credit allowed under this subdivision for taxable years beginning on or after January 1, 1999, shall not be adjusted pursuant to subdivision (i) for any taxable year beginning before January 1, 2000.

(e) A credit for personal exemption of fifty-one dollars ($51) for taxable years beginning on or after January 1, 1987, and before January 1, 1988, and fifty-two dollars ($52) for taxable years beginning on or after January 1, 1988, for the taxpayer if he or she is blind at the end of his or her taxable year.

(f) A credit for personal exemption of fifty-one dollars ($51) for taxable years beginning on or after January 1, 1987, and before January 1, 1988, and fifty-two dollars ($52) for taxable years beginning on or after January 1, 1988, for the spouse of the taxpayer if a separate return is made by the taxpayer, and if the spouse is blind and, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer.

(g) For the purposes of this section, an individual is blind only if either: his or her central visual acuity does not exceed 20/200 in the better eye with correcting lenses, or his or her visual acuity is greater than 20/200 but is accompanied by a limitation in the fields of vision such that the widest diameter of the visual field subtends an angle no greater than 20 degrees.

(h) In the case of an individual with respect to whom a credit under this section is allowable to another taxpayer for a taxable year beginning in the calendar year in which the individual's taxable year begins, the credit amount applicable to that individual for that individual's taxable year shall be zero.

(i) For each taxable year beginning on or after January 1, 1989, the Franchise Tax Board shall compute the credits prescribed in this section. That computation shall be made as follows:

(1) The California Department of Industrial Relations shall transmit annually to the Franchise Tax Board the percentage change in the California Consumer Price Index as modified for rental equivalent homeownership for all items from June of the prior calendar year to June of the current calendar year, no later than August 1 of the current calendar year.

(2) The Franchise Tax Board shall add 100 percent to the percentage change figure which is furnished to them pursuant to paragraph (1), and divide the result by 100.

(3) The Franchise Tax Board shall multiply the immediately preceding taxable year credits by the inflation adjustment factor determined in paragraph (2), and round off the resulting products to the nearest one dollar ($1).

(4) In computing the credits pursuant to this subdivision, the credit provided in subdivision (b) shall be twice the credit provided in subdivision (a).

(j) The amendments made to this section by the act adding this subdivision shall be applied only in the computation of taxes for taxable years beginning on or after January 1, 1990.

SEC. 1.5. Section 17054 of the Revenue and Taxation Code is amended to read:

17054. In the case of individuals, the following credits for personal exemption may be deducted from the tax imposed under Section 17041 or 17048, less any increases imposed under paragraph (1) of subdivision (d) or paragraph (1) of subdivision (e), or both, of Section 17560.

(a) In the case of a single individual, a head of household, or a married individual making a separate return, a credit of fifty-one dollars ($51) for taxable years beginning on or after January 1, 1987, and before January 1, 1988, and fifty-two dollars ($52) for taxable years beginning on or after January 1, 1988.

(b) In the case of a surviving spouse (as defined in Section 17046), or a husband and wife making a joint return, a credit of one hundred two dollars ($102) for taxable years beginning on or after January 1, 1987, and before January 1, 1988, and one hundred four dollars ($104) for taxable years beginning on or after January 1, 1988. If one spouse was a resident for the entire taxable year and the other spouse was a nonresident for all or any portion of the taxable year, the personal exemption shall be divided equally.

(c) In addition to any other credit provided in this section, in the case of an individual who is 65 years of age or over by the end of the taxable year, a credit of fifty-one dollars ($51) for taxable years beginning on or after January 1, 1987, and before January 1, 1988, and fifty-two dollars ($52) for taxable years beginning on or after January 1, 1988.

(d) (1) A credit of fifty-one dollars ($51) for taxable years beginning on or after January 1, 1987, and before January 1, 1988, fifty-two dollars ($52) for taxable years beginning on or after January 1, 1988, and before January 1, 1998, one hundred twenty dollars ($120) for taxable years beginning on or after January 1, 1998, and before January 1, 1999, and two hundred twenty-two dollars ($222) for taxable years beginning on or after January 1, 1999, for each dependent (as defined in Section 17056) for whom an exemption is allowable under Section 151(c) of the Internal Revenue Code, relating to additional exemption for dependents. The increased credit allowed under this subdivision for taxable years beginning on or after January 1, 1999, shall not be adjusted pursuant to subdivision (i) for any taxable year beginning before January 1, 2000.

(2) The credit allowed under paragraph (1) shall not be denied on the basis that the identification number of the dependent, as defined in Section 17056, for whom an exemption is allowable under Section 151(c) of the Internal Revenue Code, relating to additional

exemption for dependents, is not included on the return claiming the credit.

(e) A credit for personal exemption of fifty-one dollars ($51) for taxable years beginning on or after January 1, 1987, and before January 1, 1988, and fifty-two dollars ($52) for taxable years beginning on or after January 1, 1988, for the taxpayer if he or she is blind at the end of his or her taxable year.

(f) A credit for personal exemption of fifty-one dollars ($51) for taxable years beginning on or after January 1, 1987, and before January 1, 1988, and fifty-two dollars ($52) for taxable years beginning on or after January 1, 1988, for the spouse of the taxpayer if a separate return is made by the taxpayer, and if the spouse is blind and, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer.

(g) For the purposes of this section, an individual is blind only if either: his or her central visual acuity does not exceed 20/200 in the better eye with correcting lenses, or his or her visual acuity is greater than 20/200 but is accompanied by a limitation in the fields of vision such that the widest diameter of the visual field subtends an angle no greater than 20 degrees.

(h) In the case of an individual with respect to whom a credit under this section is allowable to another taxpayer for a taxable year beginning in the calendar year in which the individual's taxable year begins, the credit amount applicable to that individual for that individual's taxable year shall be zero.

(i) For each taxable year beginning on or after January 1, 1989, the Franchise Tax Board shall compute the credits prescribed in this section. That computation shall be made as follows:

(1) The California Department of Industrial Relations shall transmit annually to the Franchise Tax Board the percentage change in the California Consumer Price Index as modified for rental equivalent homeownership for all items from June of the prior calendar year to June of the current calendar year, no later than August 1 of the current calendar year.

(2) The Franchise Tax Board shall add 100 percent to the percentage change figure which is furnished to them pursuant to paragraph (1), and divide the result by 100.

(3) The Franchise Tax Board shall multiply the immediately preceding taxable year credits by the inflation adjustment factor determined in paragraph (2), and round off the resulting products to the nearest one dollar ($1).

(4) In computing the credits pursuant to this subdivision, the credit provided in subdivision (b) shall be twice the credit provided in subdivision (a).

(j) The amendments made to this section by the act adding this subdivision shall be applied only in the computation of taxes for taxable years beginning on or after January 1, 1990.

SEC. 2. Section 17062 of the Revenue and Taxation Code is amended to read:

17062. (a) In addition to the other taxes imposed by this part, there is hereby imposed for each taxable year, a tax equal to the excess, if any, of—

(1) The tentative minimum tax for the taxable year, over

(2) The regular tax for the taxable year.

(b) For purposes of this chapter, each of the following shall apply:

(1) The tentative minimum tax shall be computed in accordance with Sections 55 to 59, inclusive, of the Internal Revenue Code, except as otherwise provided in this part.

(2) The regular tax shall be the amount of tax imposed by Section 17041 or 17048, before reduction for any credits against the tax, less any amount imposed under paragraph (1) of subdivision (d) and paragraph (1) of subdivision (e) of Section 17560.

(3) (A) The provisions of Section 55(b)(1) of the Internal Revenue Code shall be modified to provide that the tentative minimum tax for the taxable year shall be equal to the following percent of so much of the alternative minimum taxable income for the taxable year as exceeds the exemption amount, before reduction for any credits against the tax:

(i) For any taxable year beginning on or after January 1, 1991, and before January 1, 1996, 8.5 percent.

(ii) For any taxable year beginning on or after January 1, 1996, 7 percent.

(B) In the case of a nonresident or part-year resident, the tentative minimum tax shall be computed as if the nonresident or part-year resident were a resident for the entire year multiplied by the ratio of California adjusted gross income (as modified for purposes of this chapter) to total adjusted gross income from all sources (as modified for purposes of this chapter). For purposes of computing the tax under subparagraph (A) and gross income from all sources, the net operating loss deduction provided in Section 56(d) of the Internal Revenue Code shall be computed as if the taxpayer were a resident for all prior years.

(C) For purposes of this section, the term ‘‘California adjusted gross income’’ includes each of the following:

(i) For any period during which the taxpayer was a resident of this state (as defined by Section 17014), all items of adjusted gross income (as modified for purposes of this chapter), regardless of source.

(ii) For any period during which the taxpayer was not a resident of this state, only those items of adjusted gross income (as modified for purposes of this chapter) which were derived from sources within this state, determined in accordance with Chapter 11 (commencing with Section 17951).

(4) The provisions of Section 55(b)(2) of the Internal Revenue Code, relating to alternative minimum taxable income, shall be modified to provide that alternative minimum taxable income shall not include the income, adjustments, and items of tax preference attributable to any trade or business of a qualified taxpayer.

(A) For purposes of this paragraph, ‘‘qualified taxpayer’’ means a taxpayer who meets both of the following:

(i) Is the owner of, or has an ownership interest in, a trade or business.

(ii) Has aggregate gross receipts, less returns and allowances, of less than one million dollars ($1,000,000) during the taxable year from all trades or businesses of which the taxpayer is the owner or has an ownership interest, in the amount of that taxpayer’s proportionate interest in each trade or business.

(B) (i) For purposes of this paragraph, ‘‘proportionate interest’’ includes an interest in a passthrough entity.

(ii) For purposes of this paragraph, ‘‘passthrough entity’’ means any of the following:

(I) A partnership, as defined by Section 17008.

(II) An S corporation, as provided in Chapter 4.5 (commencing with Section 23800) of Part 11.

(III) A regulated investment company, as provided in Section 24871.

(IV) A real estate investment trust, as provided in Section 24872.

(V) A real estate mortgage investment conduit, as provided in Section 24874.

(5) For taxable years beginning on or after January 1, 1998, Section 55(d)(1) of the Internal Revenue Code, relating to exemption amount for taxpayers other than corporations, is modified, for purposes of this part, to provide the following exemption amounts in lieu of those contained therein:

(A) Fifty-seven thousand two hundred sixty dollars ($57,260) in the case of either of the following:

(i) A joint return.

(ii) A surviving spouse.

(B) Forty-two thousand nine hundred forty-five dollars ($42,945) in the case of an individual who is both of the following:

(i) Not a married individual.

(ii) Not a surviving spouse.

(C) Twenty-eight thousand three hundred sixty dollars ($28,360) in the case of either of the following:

(i) A married individual who files a separate return.

(ii) An estate or trust.

(6) For taxable years beginning on or after January 1, 1998, Section 55(d)(3) of the Internal Revenue Code, relating to the phaseout of

exemption amount for taxpayers other than corporations, is modified, for purposes of this part, to provide the following phaseout of exemption amounts in lieu of those contained therein:

(A) Two hundred fourteen thousand seven hundred twenty-five dollars ($214,725) in the case of a taxpayer described in subparagraph (A) of paragraph (5).

(B) One hundred sixty-one thousand forty-four dollars ($161,044) in the case of a taxpayer described in subparagraph (B) of paragraph (5).

(C) One hundred seventeen thousand three hundred sixty-two dollars ($117,362) in the case of a taxpayer described in subparagraph (C) of paragraph (5).

(7) For each taxable year beginning on or after January 1, 1999, the Franchise Tax Board shall recompute the exemption amounts prescribed in paragraph (5) and the phaseout of exemption amounts prescribed in paragraph (6). Those computations shall be made as follows:

(A) The California Department of Industrial Relations shall transmit annually to the Franchise Tax Board the percentage change in the California Consumer Price Index for all items from June of the prior calendar year to June of the current calendar year, no later than August 1 of the current calendar year.

(B) The Franchise Tax Board shall do both of the following:

(i) Compute an inflation adjustment factor by adding 100 percent to the percentage change figure that is furnished pursuant to subparagraph (A) and dividing the result by 100.

(ii) Multiply the preceding taxable year exemption amounts and the phaseout of exemption amounts by the inflation adjustment factor determined in clause (i) and round off the resulting products to the nearest one dollar ($1).

(c) (1) Section 56(b)(1)(E) of the Internal Revenue Code, relating to standard deduction and deduction for personal exemptions not allowed, is modified, for purposes of this part, to deny the standard deduction allowed by Section 17073.5.

(2) The provisions of Section 56(h) of the Internal Revenue Code, relating to adjustment based on energy preferences, shall not apply.

(d) The provisions of Section 57(a)(5) of the Internal Revenue Code, relating to tax-exempt interest shall not apply.

(e) The last two sentences of Section 57(a)(6)(B) of the Internal Revenue Code, relating to tangible personal property, shall not apply.

(f) Section 57(a) of the Internal Revenue Code, relating to items of tax preference, is modified to include as an item of tax preference an amount equal to one-half of the amount excluded from gross income for the taxable year under Section 18152.5.

(g) The provisions of Section 59(a) of the Internal Revenue Code, relating to the alternative minimum tax foreign tax credit, shall not apply.

SEC. 2.5. Section 17062 of the Revenue and Taxation Code is amended to read:

17062. (a) In addition to the other taxes imposed by this part, there is hereby imposed for each taxable year, a tax equal to the excess, if any, of—

(1) The tentative minimum tax for the taxable year, over

(2) The regular tax for the taxable year.

(b) For purposes of this chapter, each of the following shall apply:

(1) The tentative minimum tax shall be computed in accordance with Sections 55 to 59, inclusive, of the Internal Revenue Code, except as otherwise provided in this part.

(2) The regular tax shall be the amount of tax imposed by Section 17041 or 17048, before reduction for any credits against the tax, less any amount imposed under paragraph (1) of subdivision (d) and paragraph (1) of subdivision (e) of Section 17560.

(3) (A) The provisions of Section 55(b)(1) of the Internal Revenue Code shall be modified to provide that the tentative minimum tax for the taxable year shall be equal to the following percent of so much of the alternative minimum taxable income for the taxable year as exceeds the exemption amount, before reduction for any credits against the tax:

(i) For any taxable year beginning on or after January 1, 1991, and before January 1, 1996, 8.5 percent.

(ii) For any taxable year beginning on or after January 1, 1996, 7 percent.

(B) In the case of a nonresident or part-year resident, the tentative minimum tax shall be computed as if the nonresident or part-year resident were a resident for the entire year multiplied by the ratio of California adjusted gross income (as modified for purposes of this chapter) to total adjusted gross income from all sources (as modified for purposes of this chapter). For purposes of computing the tax under subparagraph (A) and gross income from all sources, the net operating loss deduction provided in Section 56(d) of the Internal Revenue Code shall be computed as if the taxpayer were a resident for all prior years.

(C) For purposes of this section, the term ‘‘California adjusted gross income’’ includes each of the following:

(i) For any period during which the taxpayer was a resident of this state (as defined by Section 17014), all items of adjusted gross income (as modified for purposes of this chapter), regardless of source.

(ii) For any period during which the taxpayer was not a resident of this state, only those items of adjusted gross income (as modified for purposes of this chapter) which were derived from sources within this state, determined in accordance with Chapter 11 (commencing with Section 17951).

(4) The provisions of Section 55(b)(2) of the Internal Revenue Code, relating to alternative minimum taxable income, shall be modified to provide that alternative minimum taxable income shall not include the income, adjustments, and items of tax preference attributable to any trade or business of a qualified taxpayer.

(A) For purposes of this paragraph, ‘‘qualified taxpayer’’ means a taxpayer who meets both of the following:

(i) Is the owner of, or has an ownership interest in, a trade or business.

(ii) Has aggregate gross receipts, less returns and allowances, of less than one million dollars ($1,000,000) during the taxable year from all trades or businesses of which the taxpayer is the owner or has an ownership interest, in the amount of that taxpayer’s proportionate interest in each trade or business.

(B) (i) For purposes of this paragraph, ‘‘proportionate interest’’ includes an interest in a passthrough entity.

(ii) For purposes of this paragraph, ‘‘passthrough entity’’ means any of the following:

(I) A partnership, as defined by Section 17008.

(II) An S corporation, as provided in Chapter 4.5 (commencing with Section 23800) of Part 11.

(III) A regulated investment company, as provided in Section 24871.

(IV) A real estate investment trust, as provided in Section 24872.

(V) A real estate mortgage investment conduit, as provided in Section 24874.

(5) For taxable years beginning on or after January 1, 1998, Section 55(d)(1) of the Internal Revenue Code, relating to exemption amount for taxpayers other than corporations is modified, for purposes of this part, to provide the following exemption amounts in lieu of those contained therein:

(A) Fifty-seven thousand two hundred sixty dollars ($57,260) in the case of either of the following:

(i) A joint return.

(ii) A surviving spouse.

(B) Forty-two thousand nine hundred forty-five dollars ($42,945) in the case of an individual who is both of the following:

(i) Not a married individual.

(ii) Not a surviving spouse.

(C) Twenty-eight thousand three hundred sixty dollars ($28,360) in the case of either of the following:

(i) A married individual who files a separate return.

(ii) An estate or trust.

(6) For taxable years beginning on or after January 1, 1998, Section 55(d)(3) of the Internal Revenue Code, relating to the phaseout of

exemption amount for taxpayers other than corporations is modified, for purposes of this part, to provide the following phaseout of exemption amounts in lieu of those contained therein:

(A) Two hundred fourteen thousand seven hundred twenty-five dollars ($214,725) in the case of a taxpayer described in subparagraph (A) of paragraph (5).

(B) One hundred sixty-one thousand forty-four dollars ($161,044) in the case of a taxpayer described in subparagraph (B) of paragraph (5).

(C) One hundred seventeen thousand three hundred sixty-two dollars ($117,362) in the case of a taxpayer described in subparagraph (C) of paragraph (5).

(7) For each taxable year beginning on or after January 1, 1999, the Franchise Tax Board shall recompute the exemption amounts prescribed in paragraph (5) and the phaseout of exemption amounts prescribed in paragraph (6). Those computations shall be made as follows:

(A) The California Department of Industrial Relations shall transmit annually to the Franchise Tax Board the percentage change in the California Consumer Price Index for all items from June of the prior calendar year to June of the current calendar year, no later than August 1 of the current calendar year.

(B) The Franchise Tax Board shall do both of the following:

(i) Compute an inflation adjustment factor by adding 100 percent to the percentage change figure that is furnished pursuant to subparagraph (A) and dividing the result by 100.

(ii) Multiply the preceding taxable year exemption amounts and the phaseout of exemption amounts by the inflation adjustment factor determined in clause (i) and round off the resulting products to the nearest one dollar ($1).

(c) Section 56(b)(1)(E) of the Internal Revenue Code, relating to standard deduction and deduction for personal exemptions not allowed, is modified, for purposes of this part, to deny the standard deduction allowed by Section 17073.5.

(d) The provisions of Section 57(a)(5) of the Internal Revenue Code, relating to tax-exempt interest shall not apply.

(e) (1) Section 57(a) of the Internal Revenue Code, relating to items of tax preference, is modified to include as an item of tax preference the amount by which the deduction allowable under Section 170 of the Internal Revenue Code, relating to charitable contributions or gifts, or Section 642(c) of the Internal Revenue Code, relating to deduction for amounts paid or permanently set aside for a charitable purpose, would be reduced if all capital gain property were taken into account at its adjusted basis.

(2) For purposes of paragraph (1), the term ‘‘capital gain property’’ has the meaning given to that term by Section 170(b)(1)(C)(iv) of the Internal Revenue Code. That term shall not

include any property to which an election under Section 170(b)(1)(C)(iii) of the Internal Revenue Code applies.

(f) Section 57(a) of the Internal Revenue Code, relating to items of tax preference, is modified to include as an item of tax preference an amount equal to one-half of the amount excluded from gross income for the taxable year under Section 18152.5.

(g) The provisions of Section 59(a) of the Internal Revenue Code, relating to the alternative minimum tax foreign tax credit, shall not apply.

SEC. 3. Section 17085.8 is added to the Revenue and Taxation Code, to read:

17085.8. (a) Section 72 of the Internal Revenue Code, relating to 10 percent additional tax on early distributions from qualified retirement plans, is modified as follows:

(1) Section 72(t)(2) of the Internal Revenue Code, relating to subsection not to apply to certain distributions, is modified to additionally provide that distributions to an individual from an individual retirement plan to the extent the distributions do not exceed the qualified higher education expenses, as defined in paragraph (2), of the taxpayer for the taxable year shall not be taken into account if those distributions are described in Section 72(t)(2)(A), 72(t)(2)(C), or 72(t)(2)(D) of the Internal Revenue Code or to the extent Section 72(t)(1) of the Internal Revenue Code does not apply to those distributions by reason of Section 72(t)(2)(B) of the Internal Revenue Code.

(2) For purposes of paragraph (1) ‘‘qualified higher education expenses’’ means qualified higher education expenses, as defined in Section 529(e)(3) of the Internal Revenue Code, for education furnished to any of the following:

(A) The taxpayer.

(B) The taxpayer’s spouse.

(C) Any child, as defined in Section 151(c)(3) of the Internal Revenue Code, or grandchild of the taxpayer or the taxpayer’s spouse, at an eligible educational institution, as defined in Section 529(e)(5) of the Internal Revenue Code, as added by Public Law 105-34.

(3) This subdivision shall apply to distributions after December 31, 1997, with respect to expenses paid after that date (in taxable years ending after that date), for education furnished in academic periods beginning after that date.

(b) (1) Section 72(t)(2) of the Internal Revenue Code, relating to subsection not to apply to certain distributions, is modified to additionally provide that distributions to an individual from an individual retirement plan which are qualified first-time homebuyer distributions, as defined in paragraph (2) shall not be taken into account if the distributions are described in Section 72(t)(2)(A), Section 72(t)(2)(C), or Section 72(t)(2)(D) of the Internal Revenue

Code, or Section 72(t)(2)(E) of the Internal Revenue Code, as added by Public Law 105-34, or to the extent Section 72(t)(1) of the Internal Revenue Code does not apply to those distributions by reason of Section 72(t)(2)(B) of the Internal Revenue Code.

(2) For purposes of this subdivision:

(A) (i) ‘‘Qualified first-time homebuyer distribution’’ means any payment or distribution received by an individual to the extent the payment or distribution is used by the individual before the close of the 120th day after the day on which that payment or distribution is received to pay qualified acquisition costs with respect to a principal residence of a first-time homebuyer who is that individual, the spouse of that individual, or any child, grandchild, or ancestor of that individual or the spouse of the child, grandchild, or ancestor.

(ii) The aggregate amount of payments or distributions received by an individual which may be treated as qualified first-time homebuyer distributions for any taxable year shall not exceed the excess (if any) of—

(I) Ten thousand dollars ($10,000), over

(II) The aggregate amounts treated as qualified first-time homebuyer distribution with respect to the individual for all prior taxable years.

(B) ‘‘Qualified acquisition costs’’ means the costs of acquiring, constructing, or reconstructing a residence. ‘‘Qualified acquisition costs’’ includes any usual or reasonable settlement, financing, or other closing costs.

(C) ‘‘First-time homebuyer’’ means any individual if both of the following apply:

(i) The individual (and if married, the individual’s spouse) had no present ownership interest in a principal residence during the two-year period ending on the date of acquisition of the principal residence to which this paragraph applies.

(ii) Section 1034(h) or 1034(k) of the Internal Revenue Code (as in effect on the day before the date of the enactment of this paragraph) did not suspend the running of any period of time specified in Section 1034 of the Internal Revenue Code (as so in effect) with respect to that individual on the day before the date the distribution is applied pursuant to subparagraph (A).

(D) ‘‘Principal residence’’ has the same meaning as when used in Section 17152.

(E) ‘‘Date of acquisition’’ means either of the following:

(i) The date on which a binding contract to acquire the principal residence to which subparagraph (A) applies is entered into.

(ii) The date on which construction or reconstruction of the principal residence is commenced.

(F) If any distribution from any individual retirement plan fails to meet the requirements of subparagraph (A) solely by reason of a delay or cancellation of the purchase or construction of the residence, the amount of the distribution may be contributed to an individual retirement plan as provided in Section 408(d)(3)(A)(i) of the Internal Revenue Code (determined by substituting ‘‘120 days’’ for ‘‘60 days’’ in that section), except that both of the following shall apply:

(i) Section 408(d)(3)(B) of the Internal Revenue Code shall not be applied to that contribution.

(ii) That amount shall not be taken into account in determining whether Section 408(d)(3)(B) of the Internal Revenue Code applies to any other amount.

(3) This subdivision shall apply to payments and distributions in taxable years beginning on or after January 1, 1998.

SEC. 4. Section 17152 of the Revenue and Taxation Code is amended to read:

17152. (a) For sales and exchanges before July 1, 1998, Section 121 of the Internal Revenue Code, relating to one-time exclusion of gain from sale of principal residence by individual who has attained age 55, is modified to additionally include both of the following:

(1) The dollar amount of the exclusion in Section 121(b) of the Internal Revenue Code shall be the same as allowed for federal purposes as determined by the taxpayer’s filing status for federal purposes even though the taxpayer is prohibited from filing a joint return pursuant to Section 18521. However, in no instance shall the total amount excludable for the sale of a principal residence exceed the maximum amount allowed by Section 121(b) of the Internal Revenue Code.

(2) The three-year period in Section 121(a)(2) of the Internal Revenue Code shall be reduced by the period of the taxpayer’s service, not to exceed 18 months, in the Peace Corps during the five-year period ending on the date of the sale or exchange.

(b) For taxable years beginning on or after January 1, 1998, in connection with sales and exchanges on and after July 1, 1998, Section 121 of the Internal Revenue Code, relating to one-time exclusion of gain from sale of principal residence by an individual who has attained age 55, shall not apply and in lieu of that section subdivisions (c) to (h), inclusive, shall apply. References in the Internal Revenue Code to Section 121 of the Internal Revenue Code shall instead be treated as a reference to subdivision (c) of this section.

(c) Gross income shall not include gain from the sale or exchange of property if, during the five-year period ending on the date of the sale or exchange, the property has been owned and used by the taxpayer as the taxpayer’s principal residence for periods aggregating two years or more. The two-year period shall be reduced by the period of the taxpayer’s service, not to exceed 18 months, in the Peace Corps during the five-year period ending on the date of the sale or exchange.

(d) (1) The amount of gain excluded from gross income under subdivision (c) with respect to any sale or exchange shall not exceed two hundred fifty thousand dollars ($250,000).

(2) Paragraph (1) shall be applied by substituting five hundred thousand dollars ($500,000) for two hundred fifty thousand dollars ($250,000) if all of the following conditions are met:

(A) A husband and wife make a joint return for the taxable year of the sale or exchange of the property.

(B) Either spouse meets the ownership requirements of subdivision (c) with respect to the property.

(C) Both spouses meet the use requirements of subdivision (c) with respect to the property.

(D) Neither spouse is ineligible for the benefits of subdivision (c) with respect to the property by reason of paragraph (3).

(3) (A) Subdivision (c) shall not apply to any sale or exchange by the taxpayer if, during the two-year period ending on the date of the sale or exchange, there was any other sale or exchange by the taxpayer to which subdivision (c) applied.

(B) Subparagraph (A) shall be applied without regard to any sale or exchange before May 7, 1997.

(4) If the taxpayer is prohibited from filing a joint return pursuant to Section 18521, subparagraph (A) of paragraph (2) shall nevertheless be treated as being satisfied if the taxpayer files a joint return for federal income tax purposes for the same taxable year. However, in no instance shall the total amount excludable from gross income under subdivision (c) with respect to any sale or exchange exceed five hundred thousand dollars ($500,000).

(e) (1) In the case of a sale or exchange that is subject to this subdivision in accordance with paragraph (2), the ownership and use requirements of subdivision (c) shall not apply and paragraph (3) of subdivision (d) shall not apply, but the amount of gain excluded from gross income under subdivision (c) with respect to the sale or exchange shall not exceed the amount that bears the same ratio to the amount that would be so excluded if those requirements had been met, as the shorter of the following two periods bears to two years:

(A) The aggregate periods, during the five-year period ending on date of the sale or exchange, during which the property has been owned and used by the taxpayer as the taxpayer’s principal residence.

(B) The period after the date of the most recent prior sale or exchange by the taxpayer to which subdivision (c) applied and before the date of the sale or exchange.

(2) This subdivision shall apply to any sale or exchange if:

(A) Subdivision (c) would not, but for this subdivision, apply to the sale or exchange by reason of either of the following:

(i) A failure to meet the ownership and use requirements of subdivision (c).

(ii) Paragraph (3) of subdivision (d).

(B) The sale or exchange is by reason of a change in place of employment, health, or, to the extent provided in regulations, unforeseen circumstances.

(f) (1) For purposes of this section, in the case of an unmarried individual whose spouse is deceased on the date of the sale or exchange of property, the period the unmarried individual owned the property shall include the period the deceased spouse owned the property before death.

(2) For purposes of this section:

(A) In the case of an individual holding property transferred to that individual in a transaction described in Section 1041(a) of the Internal Revenue Code, the period the individual owns the property shall include the period the transferor owned the property.

(B) Solely for purposes of this section, an individual shall be treated as using property as that individual's principal residence during any period of ownership while that individual's spouse or former spouse is granted use of the property under a divorce or separation instrument, as defined in Section 71(b)(2) of the Internal Revenue Code.

(3) For purposes of this section, if the taxpayer holds stock as a tenant-stockholder, as defined in Section 216 of the Internal Revenue Code, in a cooperative housing corporation, as defined in Section 216 of the Internal Revenue Code:

(A) The holding requirements of subdivision (c) shall be applied to the holding of that stock.

(B) The use requirements of subdivision (c) shall be applied to the house or apartment which the taxpayer was entitled to occupy as the stockholder.

(4) (A) For purposes of this section, the destruction, theft, seizure, requisition, or condemnation of property shall be treated as the sale of the property.

(B) In applying Section 1033 of the Internal Revenue Code, relating to involuntary conversions, the amount realized from the sale or exchange of property shall be treated as being the amount determined without regard to this section, reduced by the amount of gain not included in gross income pursuant to this section.

(C) If the basis of the property sold or exchanged is determined, in whole or in part, under Section 1033(b) of the Internal Revenue Code, relating to basis of property acquired through involuntary conversion, then the holding and use by the taxpayer of the converted property shall be treated as holding and use by the taxpayer of the property sold or exchanged.

(5) Subdivision (c) shall not apply to so much of the gain from the sale of any property as does not exceed the portion of the depreciation adjustments, as defined in Section 1250(b)(3) of the

Internal Revenue Code, attributable to periods after May 6, 1997, with respect to that property.

(6) In the case of a taxpayer who becomes physically or mentally incapable of self-care, and owns property and uses the property as the taxpayer’s principal residence during the five-year period described in subdivision (c) for periods aggregating at least one year, the taxpayer shall be treated as using the property as the taxpayer’s principal residence during any time during the five-year period in which the taxpayer owns the property and resides in any facility, including a nursing home, licensed by a state or political subdivision to care for an individual in the taxpayer’s condition.

(7) In the case of any sale or exchange, for purposes of this section:

(A) The determination of whether an individual is married shall be made as of the date of the sale or exchange.

(B) An individual legally separated from his or her spouse under a decree of divorce or of separate maintenance shall not be considered as married.

(8) For purposes of this section:

(A) At the election of the taxpayer, this section shall not fail to apply to the sale or exchange of an interest in a principal residence by reason of that interest being a remainder interest in the residence, but this section shall not apply to any other interest in that residence which is sold or exchanged separately.

(B) Subparagraph (A) shall not apply to any sale to, or exchange with, any person who bears a relationship to the taxpayer which is described in Section 267(b) or 707(b) of the Internal Revenue Code.

(g) If a taxpayer has, at any time, made an election for federal purposes under Section 121(f) of the Internal Revenue Code, as amended by Public Law 105-34, not to have Section 121 of the Internal Revenue Code, as amended by Public Law 105-34, apply to a sale or exchange, subdivision (c) of this section shall not apply to that sale or exchange, a separate election for state purposes shall not be allowed under paragraph (3) of subdivision (e) of Section 17024.5, the federal election shall be binding for purposes of this part, and that election shall be treated as an election to include in gross income for purposes of this part all the gain from the sale or exchange of property, including that amount which, but for that election, would have been excluded from income under subdivision (c) of this section.

(h) For purposes of this section, in the case of property the acquisition of which by the taxpayer resulted under Section 1034 of the Internal Revenue Code, as applicable on the day before the date of enactment of the act adding this subdivision, in the nonrecognition of any part of the gain realized on the sale or exchange of another residence, in determining the period for which the taxpayer has owned and used the property as the taxpayer’s principal residence, there shall be included the aggregate periods for which the other residence, and each prior residence taken into account under Section 1223(7) of the Internal Revenue Code in determining the holding period of the property, had been so owned and used.

(i) For sales and exchanges on or after May 7, 1997, and on or before June 30, 1998, the provisions that require a report under Section 18643 are modified to only require a copy of the federal return required to be filed with the Secretary of the Treasury under Section 6045(e) of the Internal Revenue Code, as amended by Public Law 105-34.

SEC. 4.5. Section 17152 of the Revenue and Taxation Code is amended to read:

17152. (a) For sales and exchanges before May 7, 1997, Section 121 of the Internal Revenue Code, relating to one-time exclusion of gain from sale of principal residence by individual who has attained age 55, is modified to additionally include both of the following:

(1) The dollar amount of the exclusion in Section 121(b) of the Internal Revenue Code shall be the same as allowed for federal purposes as determined by the taxpayer's filing status for federal purposes even though the taxpayer is prohibited from filing a joint return pursuant to Section 18521. However, in no instance shall the total amount excludable for the sale of a principal residence exceed the maximum amount allowed by Section 121(b) of the Internal Revenue Code.

(2) The three-year period in Section 121(a)(2) of the Internal Revenue Code shall be reduced by the period of the taxpayer's service, not to exceed 18 months, in the Peace Corps during the five-year period ending on the date of the sale or exchange.

(b) For sales and exchanges on and after May 7, 1997, Section 121 of the Internal Revenue Code, relating to one-time exclusion of gain from sale of principal residence by an individual who has attained age 55, shall not apply and in lieu of that section subdivisions (c) to (h), inclusive, shall apply. References in the Internal Revenue Code to Section 121 of the Internal Revenue Code shall instead be treated as a reference to subdivision (c) of this section.

(c) Gross income shall not include gain from the sale or exchange of property if, during the five-year period ending on the date of the sale or exchange, the property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating two years or more. The two-year period shall be reduced by the period of the taxpayer's service, not to exceed 18 months, in the Peace Corps during the five-year period ending on the date of the sale or exchange.

(d) (1) The amount of gain excluded from gross income under subdivision (c) with respect to any sale or exchange shall not exceed two hundred fifty thousand dollars ($250,000).

(2) Paragraph (1) shall be applied by substituting five hundred thousand dollars ($500,000) for two hundred fifty thousand dollars ($250,000) if all of the following conditions are met:

(A) A husband and wife make a joint return for the taxable year of the sale or exchange of the property.

(B) Either spouse meets the ownership requirements of subdivision (c) with respect to the property.

(C) Both spouses meet the use requirements of subdivision (c) with respect to the property.

(D) Neither spouse is ineligible for the benefits of subdivision (c) with respect to the property by reason of paragraph (3).

(3) (A) Subdivision (c) shall not apply to any sale or exchange by the taxpayer if, during the two-year period ending on the date of the sale or exchange, there was any other sale or exchange by the taxpayer to which subdivision (c) applied.

(B) Subparagraph (A) shall be applied without regard to any sale or exchange before May 7, 1997.

(4) If the taxpayer is prohibited from filing a joint return pursuant to Section 18521, subparagraph (A) of paragraph (2) shall nevertheless be treated as being satisfied if the taxpayer files a joint return for federal income tax purposes for the same taxable year. However, in no instance shall the total amount excludable from gross income under subdivision (c) with respect to any sale or exchange exceed five hundred thousand dollars ($500,000).

(e) (1) In the case of a sale or exchange that is subject to this subdivision in accordance with paragraph (2), the ownership and use requirements of subdivision (c) shall not apply and paragraph (3) of subdivision (d) shall not apply, but the amount of gain excluded from gross income under subdivision (c) with respect to the sale or exchange shall not exceed the amount that bears the same ratio to the amount that would be so excluded if those requirements had been met, as the shorter of the following two periods bears to two years:

(A) The aggregate periods, during the five-year period ending on the date of the sale or exchange, during which the property has been owned and used by the taxpayer as the taxpayer's principal residence.

(B) The period after the date of the most recent prior sale or exchange by the taxpayer to which subdivision (c) applied and before the date of the sale or exchange.

(2) This subdivision shall apply to any sale or exchange if:

(A) Subdivision (c) would not, but for this subdivision, apply to the sale or exchange by reason of either of the following:

(i) A failure to meet the ownership and use requirements of subdivision (c).

(ii) Paragraph (3) of subdivision (d).

(B) The sale or exchange is by reason of a change in place of employment, health, or, to the extent provided in regulations, unforeseen circumstances.

(f) (1) For purposes of this section, in the case of an unmarried individual whose spouse is deceased on the date of the sale or exchange of property, the period the unmarried individual owned the property shall include the period the deceased spouse owned the property before death.

(2) For purposes of this section:

(A) In the case of an individual holding property transferred to that individual in a transaction described in Section 1041(a) of the Internal Revenue Code, the period the individual owns the property shall include the period the transferor owned the property.

(B) Solely for purposes of this section, an individual shall be treated as using property as that individual's principal residence during any period of ownership while that individual's spouse or former spouse is granted use of the property under a divorce or separation instrument, as defined in Section 71(b)(2) of the Internal Revenue Code.

(3) For purposes of this section, if the taxpayer holds stock as a tenant-stockholder, as defined in Section 216 of the Internal Revenue Code, in a cooperative housing corporation, as defined in Section 216 of the Internal Revenue Code:

(A) The holding requirements of subdivision (c) shall be applied to the holding of that stock.

(B) The use requirements of subdivision (c) shall be applied to the house or apartment which the taxpayer was entitled to occupy as the stockholder.

(4) (A) For purposes of this section, the destruction, theft, seizure, requisition, or condemnation of property shall be treated as the sale of the property.

(B) In applying Section 1033 of the Internal Revenue Code, relating to involuntary conversions, the amount realized from the sale or exchange of property shall be treated as being the amount determined without regard to this section, reduced by the amount of gain not included in gross income pursuant to this section.

(C) If the basis of the property sold or exchanged is determined, in whole or in part, under Section 1033(b) of the Internal Revenue Code, relating to basis of property acquired through involuntary conversion, then the holding and use by the taxpayer of the converted property shall be treated as holding and use by the taxpayer of the property sold or exchanged.

(5) Subdivision (c) shall not apply to so much of the gain from the sale of any property as does not exceed the portion of the depreciation adjustments, as defined in Section 1250(b)(3) of the Internal Revenue Code, attributable to periods after May 6, 1997, with respect to that property.

(6) In the case of a taxpayer who becomes physically or mentally incapable of self-care, and owns property and uses the property as the taxpayer's principal residence during the five-year period described in subdivision (c) for periods aggregating at least one year, the taxpayer shall be treated as using the property as the taxpayer's principal residence during any time during the five-year period in which the taxpayer owns the property and resides in any facility, including a nursing home, licensed by a state or political subdivision to care for an individual in the taxpayer's condition.

(7) In the case of any sale or exchange, for purposes of this section:

(A) The determination of whether an individual is married shall be made as of the date of the sale or exchange.

(B) An individual legally separated from his or her spouse under a decree of divorce or of separate maintenance shall not be considered as married.

(8) For purposes of this section:

(A) At the election of the taxpayer, this section shall not fail to apply to the sale or exchange of an interest in a principal residence by reason of that interest being a remainder interest in the residence, but this section shall not apply to any other interest in that residence which is sold or exchanged separately.

(B) Subparagraph (A) shall not apply to any sale to, or exchange with, any person who bears a relationship to the taxpayer which is described in Section 267(b) or 707(b) of the Internal Revenue Code.

(g) If a taxpayer has, at any time, made an election for federal purposes under Section 121(f) of the Internal Revenue Code, as amended by Public Law 105-34, not to have Section 121 of the Internal Revenue Code, as amended by Public Law 105-34, apply to a sale or exchange, subdivision (c) of this section shall not apply to that sale or exchange, a separate election for state purposes shall not be allowed under paragraph (3) of subdivision (e) of Section 17024.5, the federal election shall be binding for purposes of this part, and that election shall be treated as an election to include in gross income for purposes of this part all the gain from the sale or exchange of property, including that amount which, but for that election, would have been excluded from income under subdivision (c) of this section.

(h) For purposes of this section, in the case of property the acquisition of which by the taxpayer resulted under Section 1034 of the Internal Revenue Code, as applicable on the day before the date of enactment of the act adding this subdivision, in the nonrecognition of any part of the gain realized on the sale or exchange of another residence, in determining the period for which the taxpayer has owned and used the property as the taxpayer's principal residence, there shall be included the aggregate periods for which the other residence, and each prior residence taken into account under Section

1223(7) of the Internal Revenue Code in determining the holding period of the property, had been so owned and used.

(i) For sales and exchanges on or after May 7, 1997, the provisions that require a report under Section 18643 are modified to only require a copy of the federal return required to be filed with the Secretary of the Treasury under Section 6045(e) of the Internal Revenue Code, as amended by Public Law 105-34.

SEC. 5. Section 17210.6 is added to the Revenue and Taxation Code, to read:

17210.6. For taxable years beginning on or after January 1, 1998, Section 219 of the Internal Revenue Code, relating to retirement savings, is modified as follows:

(a) Section 219(c)(1)(B)(ii) of the Internal Revenue Code is modified to substitute, in lieu of the language in that clause, ‘‘the compensation includable in the gross income of that individual’s spouse for the taxable year reduced by both of the following:

(1) The amount allowed as a deduction under Section 219(a) of the Internal Revenue Code to that spouse for that taxable year.

(2) The amount of any contribution on behalf of that spouse to a Roth IRA under Section 17507.6 of that taxable year.’’

(b) Section 219(g)(1) of the Internal Revenue Code is modified as follows:

(1) By substituting the phrase ‘‘an individual’’ in lieu of the phrase ‘‘an individual or the individual’s spouse.’’

(2) In the case of an individual who is an active participant at no time during any plan year ending with or within the taxable year but whose spouse is an active participant for any part of any of those plan years both of the following shall apply:

(A) The applicable dollar amount under Section 219(g)(3)(B)(i) of the Internal Revenue Code with respect to the taxpayer shall be one hundred fifty thousand dollars ($150,000).

(B) The amount applicable under Section 219(g)(2)(A)(ii) shall be ten thousand dollars ($10,000).

(c) Section 219(g)(2)(A)(ii) of the Internal Revenue Code is modified by substituting ‘‘ten thousand dollars ($10,000), twenty thousand dollars ($20,000) in the case of a joint return for a taxable year beginning on or after January 1, 2007)’’ in lieu of ‘‘ten thousand dollars ($10,000).’’

(d) Section 219(g)(3)(B) of the Internal Revenue Code is modified to provide that ‘‘applicable dollar amount’’ means, in lieu of the amounts provided therein, the following:

(1) In the case of a taxpayer filing a joint return:

For taxable years beginning in:	The applicable dollar amount is:
1998	$50,000

1999	$51,000
2000	$52,000
2001	$53,000
2002	$54,000
2003	$60,000
2004	$65,000
2005	$70,000
2006	$75,000
2007 and thereafter	$80,000

(2) In the case of any other taxpayer (other than a married individual filing a separate return):

For taxable years beginning in:	The applicable dollar amount is:
1998	$30,000
1999	$31,000
2000	$32,000
2001	$33,000
2002	$34,000
2003	$40,000
2004	$45,000
2005 and thereafter	$50,000

(3) In the case of a married individual filing a separate return, zero.

SEC. 6. Section 17273 of the Revenue and Taxation Code is amended to read:

17273. Section 162(*l*)(1) of the Internal Revenue Code, relating to applicable percentage, is modified by substituting ‘‘25 percent’’ for the percentages specified in that section.

SEC. 7. Section 17507.4 is added to the Revenue and Taxation Code, to read:

17507.4. Section 408 of the Internal Revenue Code, relating to individual retirement accounts is modified as follows:

(a) Section 408(i) of the Internal Revenue Code is modified as follows:

(1) By substituting ‘‘may require’’ in lieu of ‘‘may require under regulations.’’

(2) By substituting ‘‘prescribes’’ in lieu of ‘‘prescribes in such regulations’’ in each place it appears.

(b) Section 408(m)(3) of the Internal Revenue Code shall not apply and in lieu thereof, ‘‘collectible’’ shall not include either of the following:

(A) Any coin which is any of the following:

(i) A gold coin described in Section 5112(a)(7), 5112(a)(8), 5112(a)(9), or 5112(a)(10) of Title 31 of the United States Code.

(ii) A silver coin described in Section 5112(e) of Title 31 of the United States Code.

(iii) A platinum coin described in Section 5112(k) of Title 31 of the United States Code.

(iv) A coin issued under the laws of any state.

(B) Any gold, silver, platinum, or palladium bullion of a fineness equal to or exceeding the minimum fineness that a contract market as described in Section 7 of the Commodity Exchange Act (7 U.S.C. Sec. 7) requires for metals which may be delivered in satisfaction of a regulated futures contract, if that bullion is in the physical possession of a trustee described under Section 408(a) of the Internal Revenue Code.

(c) This section shall apply to taxable years beginning on or after January 1, 1998.

SEC. 8. Section 17507.6 is added to the Revenue and Taxation Code, to read:

17507.6. (a) Except as provided in this section, a Roth IRA shall be treated for purposes of this part in the same manner as an individual retirement plan.

(b) For purposes of this part, ‘‘Roth IRA’’ means an individual retirement plan (as described in Section 7701(a)(37) of the Internal Revenue Code) which is designated at the time of establishment of the plan as a Roth IRA. That designation shall be made in the manner as the Secretary of the Treasury may prescribe unless the Franchise Tax Board prescribes differently.

(c) (1) No deduction shall be allowed under Section 219 of the Internal Revenue Code for a contribution to a Roth IRA.

(2) The aggregate amount of contributions for any taxable year to all Roth IRAs maintained for the benefit of an individual shall not exceed the excess, if any, of—

(A) The maximum amount allowable as a deduction under Section 219 of the Internal Revenue Code with respect to that individual for that taxable year (computed without regard to Section 219(d)(1) or 219(g) of the Internal Revenue Code, over

(B) The aggregate amount of contributions for that taxable year to all other individual retirement plans (other than Roth IRAs) maintained for the benefit of the individual.

(3) (A) The amount determined under paragraph (2) for any taxable year shall be reduced (but not below zero) by the amount which bears the same ratio to that amount as—

(i) The excess of—

(I) The amount required to be shown as adjusted gross income on the taxpayer's federal tax return for that same taxable year, over

(II) The applicable dollar amount, bears to

(ii) Fifteen thousand dollars ($15,000) (ten thousand dollars ($10,000) in the case of a joint return). The rules of subparagraphs (B) and (C) of Section 219(g)(2) shall apply to any reduction under this subparagraph.

(B) A taxpayer shall not be allowed to make a qualified rollover contribution to a Roth IRA from an individual retirement plan other than a Roth IRA during any taxable year if either of the following occur:

(i) The amount required to be shown as adjusted gross income on the taxpayer's federal tax return for that same taxable year exceeds one hundred thousand dollars ($100,000).

(ii) The taxpayer is a married individual filing a separate return.

(C) For purposes of this paragraph:

(i) Federal adjusted gross income shall be determined in the same manner as under Section 219(g)(3) of the Internal Revenue Code, except that any amount included in gross income under paragraph (3) of subdivision (d) shall not be taken into account and the deduction under Section 219 of the Internal Revenue Code shall be taken into account, and

(ii) The applicable dollar amount is:

(I) In the case of a taxpayer filing a joint return, one hundred and fifty thousand dollars ($150,000).

(II) In the case of any other taxpayer (other than a married individual filing a separate return), ninety-five thousand dollars ($95,000).

(III) In the case of a married individual filing a separate return, zero.

(D) Section 219(g)(4) of the Internal Revenue Code shall apply for purposes of this paragraph.

(4) Contributions to a Roth IRA may be made even after the individual for whom the account is maintained has attained age 70 $^{1}/_{2}$ years.

(5) Notwithstanding Sections 408(a)(6) and 408(b)(3) of the Internal Revenue Code, relating to required distributions, the following provisions shall not apply to any Roth IRA:

(A) Section 401(a)(9)(A) of the Internal Revenue Code.

(B) The incidental death benefit requirements of Section 401(a) of the Internal Revenue Code.

(6)(A) No rollover contribution may be made to a Roth IRA unless it is a qualified rollover contribution.

(B) A qualified rollover contribution shall not be taken into account for purposes of paragraph (2).

(7) For purposes of this section, the rule of Section 219(f)(3) of the Internal Revenue Code shall apply.

(d) For purposes of this part:

(1) (A) Any qualified distribution from a Roth IRA shall not be includable in gross income.

(B) In applying Section 72 to any distribution from a Roth IRA which is not a qualified distribution, the distribution shall be treated as made from contributions to the Roth IRA to the extent that the distribution, when added to all previous distributions from the Roth IRA, does not exceed the aggregate amount of contributions to the Roth IRA.

(2) For purposes of this subdivision:

(A) ‘‘Qualified distribution’’ means any payment or distribution that is any of the following:

(i) Made on or after the date on which the individual attains age 59 $^{1}/_{2}$.

(ii) Made to a beneficiary (or to the estate of the individual) on or after the death of the individual.

(iii) Attributable to the individual’s being disabled (within the meaning of Section 72(m)(7) of the Internal Revenue Code).

(iv) A qualified special purpose distribution.

(B) A payment or distribution shall not be treated as a qualified distribution under subparagraph (A) if either of the following apply:

(i) It is made within the five-taxable year period beginning with the first taxable year for which the individual made a contribution to a Roth IRA (or the individual’s spouse made a contribution to a Roth IRA) established for that individual.

(ii) In the case of a payment or distribution properly allocable (as determined in the manner prescribed by the Secretary of the Treasury, unless the Franchise Tax Board prescribes otherwise) to a qualified rollover contribution from an individual retirement plan other than a Roth IRA (or income allocable thereto), it is made within the five-taxable year period beginning with the taxable year in which the rollover contribution was made.

(3) (A) Notwithstanding Section 408(d)(3) of the Internal Revenue Code, in the case of any distribution to which this paragraph applies, all of the following shall apply:

(i) There shall be included in gross income any amount which would be includable were it not part of a qualified rollover contribution.

(ii) Section 72(t) of the Internal Revenue Code shall not apply.

(iii) In the case of a distribution before January 1, 1999, any amount required to be included in gross income by reason of this paragraph shall be so included ratably over the four-taxable year period beginning with the taxable year in which the payment or distribution is made.

(B) This paragraph shall apply to a distribution from an individual retirement plan (other than a Roth IRA) maintained for the benefit of an individual which is contributed to a Roth IRA maintained for the benefit of that individual in a qualified rollover contribution.

(C) The conversion of an individual retirement plan (other than a Roth IRA) to a Roth IRA shall be treated for purposes of this paragraph as a distribution to which this paragraph applies.

(D) If, no later than the due date for filing the return of tax for any taxable year (without regard to extension), an individual transfers, from an individual retirement plan (other than a Roth IRA), contributions for that taxable year (and any earnings allocable thereto) to a Roth IRA, none of that amount shall be includable in gross income to the extent no deduction was allowed with respect to that amount.

(E) Trustees of Roth IRAs, trustees of individual retirement plans, or both, whichever is appropriate, shall include the additional information in reports required under Section 17507 and Section 408(i) of the Internal Revenue Code as either the Franchise Tax Board or the Secretary of the Treasury may require to ensure that amounts required to be included in gross income under subparagraph (A) are so included.

(4) Section 408(d)(2) of the Internal Revenue Code shall be applied separately with respect to Roth IRAs and other individual retirement plans.

(e) For purposes of this section:

(1) ‘‘Qualified special purpose distribution’’ means any distribution to which Section 72(t)(2)(F) of the Internal Revenue Code, as amended by Public Law 105-34, applies.

(2) (A) Paragraph (3) of subdivision (d) shall not apply if any distribution which is not a qualified distribution under paragraph (2) of subdivision (d) is made from a Roth IRA within the five-taxable-year period beginning with the taxable year in which a distribution to which paragraph (3) of subdivision (d) would otherwise apply is made.

(B) In the case of any distribution to which subparagraph (A) applies:

(i) There shall be included in gross income in the taxable year in which the disqualifying distribution described in subparagraph (A) is made any amount that has not been previously included in gross income under clause (iii) of subparagraph (A) of paragraph (2) of subdivision (d) and which would be includable in income were it not treated as part of a qualified rollover contribution.

(ii) In the taxable year in which the disqualifying distribution described in subparagraph (A) is made, Section 72(t) of the Internal Revenue Code shall be applied to the amount which was treated as includable in gross income under clause (i) of subparagraph (A) of paragraph (2) of subdivision (d).

(3) For purposes of this section, ‘‘qualified rollover contribution’’ means a rollover contribution to a Roth IRA from another Roth IRA

account, or from an individual retirement plan, but only if the rollover contribution meets the requirements of Section 408(d)(3) of the Internal Revenue Code. For purposes of Section 408(d)(3)(B) of the Internal Revenue Code, there shall be disregarded any qualified rollover contribution from an individual retirement plan (other than a Roth IRA) to a Roth IRA.

(f) This section shall apply to taxable years beginning on or after January 1, 1998.

SEC. 9. Section 18037.6 is added to the Revenue and Taxation Code, to read:

18037.6. For sales and exchanges after July 1, 1998:

(a) Section 1034 of the Internal Revenue Code, relating to rollover of gain on sale of principal residence, shall not apply.

(b) References in Sections 56(e), 163(h), 280A(d), 464(f), 1033(h), 1274(c), and 7872(f) of the Internal Revenue Code, and paragraph (3) of subdivision (e) of Section 18662 of the Revenue and Taxation Code, to Section 1034 of the Internal Revenue Code, shall instead be treated as a reference to Section 17152 of the Revenue and Taxation Code.

(c) Section 216(e) of the Internal Revenue Code is modified by substituting ‘‘such dwelling unit is used as his or her principal residence (with the meaning of Section 17152)’’ for the phrase ‘‘such exchange qualifies for nonrecognition of gain under Section 1034(f).’’

(d) References in Sections 512(a), 1016(a), and 1223(7) of the Internal Revenue Code to Section 1034 of the Internal Revenue Code shall be treated as a reference to that section as in effect on the day before the date of the enactment of the act adding this section.

(e) Section 1038(e) of the Internal Revenue Code, relating to principal residences, shall be modified to provide that, under regulations prescribed by the Secretary of the Treasury under Section 1038 of the Internal Revenue Code, unless the Franchise Tax Board prescribes otherwise, Section 1038(b), (c), and (d) of the Internal Revenue Code shall not apply to the reacquisition of property and, for purposes of applying Section 17152, the resale of that property shall be treated as a part of the transaction constituting the original sale of the property, if both of the following apply:

(1) Section 1038(a) of the Internal Revenue Code applies to a reacquisition of real property with respect to the sale of which gain was not recognized under Section 17152.

(2) Within one year after the date of reacquisition of the property by the seller, that property is resold by him or her.

(f) Section 1250(d)(7) of the Internal Revenue Code, relating to disposition of principal residence, shall not apply.

(g) Section 1250(e)(3) of the Internal Revenue Code, relating to principal residence, shall not apply.

SEC. 10. Section 18510 of the Revenue and Taxation Code is amended to read:

18510. For purposes of Sections 18501, 18505, and 18521, gross income shall be computed without regard to the exclusion provided for in Section 17152.

SEC. 11. Section 19184 of the Revenue and Taxation Code is amended to read:

19184. (a) A penalty of fifty dollars ($50) shall be imposed for each failure, unless it is shown that the failure is due to reasonable cause, by any person required to file who fails to file a report at the time and in the manner required by any of the following provisions:

(1) Subdivision (c) of Section 17507, relating to individual retirement accounts.

(2) Section 220(h) of the Internal Revenue Code, relating to medical savings accounts.

(3) Subdivision (h) of Section 23712, relating to education individual retirement accounts.

(b) (1) Any individual who:

(A) Is required to furnish information under Section 17508 as to the amount designated nondeductible contributions made for any taxable year, and

(B) Overstates the amount of those contributions made for that taxable year, shall pay a penalty of one hundred dollars ($100) for each overstatement unless it is shown that the overstatement is due to reasonable cause.

(2) Any individual who fails to file a form required to be filed by the Franchise Tax Board under Section 17508 shall pay a penalty of fifty dollars ($50) for each failure unless it is shown that the failure is due to reasonable cause.

(c) Article 3 (commencing with Section 19031) of this chapter (relating to deficiency assessments) shall not apply in respect of the assessment or collection of any penalty imposed under this section.

SEC. 12. Section 23712 is added to the Revenue and Taxation Code, to read:

23712. (a) An education individual retirement account shall be exempt from taxation under Part 10 (commencing with Section 17001) and this part. Notwithstanding the preceding sentence, the education individual retirement account shall be subject to the taxes imposed by Article 2 (commencing with Section 23731).

(b) For purposes of this section:

(1) ‘‘Education individual retirement account’’ means a trust created or organized in the United States exclusively for the purpose of paying the qualified higher education expenses of the designated beneficiary of the trust (and designated as an education individual retirement account at the time created or organized), but only if the written governing instrument creating the trust meets the following requirements:

(A) No contribution will be accepted under any of the following conditions:

(i) In any form other than in cash.

(ii) After the date on which the beneficiary attains 18 years of age.

(iii) Except in the case of rollover contributions, if those contribution would result in aggregate contributions for the taxable year exceeding five hundred dollars ($500).

(B) The trustee is a bank (as defined in Section 408(n) of the Internal Revenue Code) or another person who demonstrates to the satisfaction of the Secretary of the Treasury, unless the Franchise Tax Board determines otherwise, that the manner in which that person will administer the trust will be consistent with the requirements of this section or who has so demonstrated with respect to any individual retirement plan.

(C) No part of the trust assets will be invested in life insurance contracts.

(D) The assets of the trust shall not be commingled with other property except in a common trust fund or common investment fund.

(E) Upon the death of the designated beneficiary, any balance to the credit of the beneficiary shall be distributed within 30 days after the date of death to the estate of that beneficiary.

(F) Upon the date of the designated beneficiary becomes 30 years of age, any balance to the credit of the beneficiary shall be distributed within 30 days after the date the beneficiary becomes 30 years of age to that beneficiary.

(2) (A) ‘‘Qualified higher education expenses’’ has the meaning given that term by Section 529(e)(3) of the Internal Revenue Code.

(B) ‘‘Qualified high education expenses’’ shall include amounts paid or incurred to make contributions to an account, under a qualified state tuition program (as defined in Section 529(b) of the Internal Revenue Code) for the benefit of the beneficiary of the account.

(3) ‘‘Eligible educational institution’’ has the meaning given that term by Section 529(e)(5) of the Internal Revenue Code, as added by Public Law 105-34.

(c) (1) The maximum amount which a contributor could otherwise make to an account under this section shall be reduced by an amount which bears the same ratio to that maximum amount as—

(A) The excess of—

(i) The contributor’s modified adjusted gross income for the taxable year, over

(ii) Ninety-five thousand dollars ($95,000) (one hundred fifty thousand dollars ($150,000) in the case of a joint return), bears to

(B) Fifteen thousand dollars ($15,000) (ten thousand dollars ($10,000) in the case of a joint return).

(2) For purposes of paragraph (1), ‘‘modified adjusted gross income’’ means the amount required to be shown as adjusted gross income of the taxpayer on the federal tax return for the same taxable

year, increased by any amount excluded from federal adjusted gross income under Section 911, 931, or 933 of the Internal Revenue Code on the federal tax return for the same taxable year.

(d) (1) Any distribution shall be includable in the gross income of the distributee under Part 10 (commencing with Section 17001) in the manner as provided in Section 72(b) of the Internal Revenue Code, as modified by Part 10.

(2) (A) No amount shall be includable under paragraph (1) if the qualified higher education expenses of the designated beneficiary during the taxable year are not less than the aggregate distributions during the taxable year.

(B) If the aggregate distributions exceed those expenses during the taxable year, the amount includable in gross income under paragraph (1) shall be equal to the amount which bears the same ratio to the amount which would be includable in gross income under paragraph (1) (without regard to this subparagraph) as the qualified higher education expenses bear to those aggregate distributions.

(C) A taxpayer that has elected to waive the application of Section 530(d)(2) of the Internal Revenue Code (as added by P.L. 105-34), shall be treated as having waived the application of this paragraph, a separate election for state purposes shall not be allowed under paragraph (3) of subdivision (e) of Section 17024.5 or paragraph (3) of subdivision (e) of Section 23051.5, and the federal election shall be binding for purposes of Part 10 (commencing with Section 17001) and this part.

(3) (A) The tax imposed by Part 10 (commencing with Section 17001) for any taxable year on any taxpayer who receives a payment or distribution from an education individual retirement account which is includable in the gross income of that taxpayer under this subdivision shall be increased by 2 $^{1}/_{2}$ percent of the amount which is so includable.

(B) Subparagraph (A) shall not apply if the payment or distribution is—

(i) Made to a beneficiary (or to the estate of the designated beneficiary) on or after the death of the designated beneficiary,

(ii) Attributable to the designated beneficiary's being disabled (within the meaning of Section 72(m)(7) of the Internal Revenue Code), or

(iii) Made on account of a scholarship, allowance, or payment described in Section 25A(g)(2) of the Internal Revenue Code, as added by Public Law 105-34, received by the accountholder to the extent the amount of the payment or distribution does not exceed the amount of the scholarship, allowance, or payment.

(C) (i) Subparagraph (A) shall not apply to the distribution of any contribution made during a taxable year on behalf of a designated beneficiary to the extent that the contribution exceeds five hundred dollars ($500) if—

(I) The distribution is received on or before the day prescribed by law (including extensions of time) for filing that contributor's return for the taxable year, and

(II) The distribution is accompanied by the amount of net income attributable to that excess contribution.

(ii) Any net income described in clause (II) shall be included in the contributor's gross income under Part 10 (commencing with Section 17001) or this part for the taxable year in which that excess contribution was made.

(4) Paragraph (1) shall not apply to any amount paid or distributed from an education individual retirement account to the extent that the amount received is paid into another education individual retirement account for the benefit of the same beneficiary or a member of the family (within the meaning of Section 529(e)(2) of the Internal Revenue Code) of that beneficiary not later than the 60th day after the date of that payment or distribution. The preceding sentence shall not apply to any payment or distribution if it applied to any prior payment or distribution during the 12-month period ending on the date of the payment or distribution.

(5) Any change in the beneficiary of an education individual retirement account shall not be treated as a distribution for purposes of paragraph (1) if the new beneficiary is a member of the family (as so defined) of the old beneficiary.

(6) Rules similar to the rules of paragraphs (7) and (8) of Section 220(f) of the Internal Revenue Code shall apply.

(e) Rules similar to the rules of paragraphs (2) and (4) of Section 408(e) of the Internal Revenue Code shall apply to any education individual retirement account.

(f) This section shall be applied without regard to any community property laws.

(g) For purposes of this section, a custodial account shall be treated as a trust if the assets of the account are held by a bank (as defined in Section 408(n) of the Internal Revenue Code) or another person who demonstrates, to the satisfaction of the Secretary of the Treasury, unless the Franchise Tax Board determines otherwise, that the manner in which he or she will administer the account will be consistent with the requirements of this section, and if the custodial account would, except for the fact that it is not a trust, constitute an account described in paragraph (1) of subdivision (b). For purposes of Part 10 (commencing with Section 17001) and this part, in the case of a custodial account treated as a trust by reason of the preceding sentence, the custodian of that account shall be treated as the trustee thereof.

(h) A copy of the report, which is required to be filed with the Secretary of the Treasury under Section 530(h) of the Internal Revenue Code, as enacted by Section 213 of the Taxpayer Relief Act of 1997 (P.L. 105-34), shall be filed with the Franchise Tax Board at the same time and in the same manner as specified in that section.

(i) This section shall apply to taxable and income years beginning on or after January 1, 1998.

SEC. 13. Section 23802 of the Revenue and Taxation Code is amended to read:

23802. (a) Section 1363(a) of the Internal Revenue Code, relating to the taxability of an ''S corporation,'' shall not be applicable.

(b) Corporations qualifying under this chapter shall continue to be subject to the taxes imposed under Chapter 2 (commencing with Section 23101) and Chapter 3 (commencing with Section 23501), except as follows:

(1) The tax imposed under Section 23151 or 23501 shall be imposed at a rate of $1^1/_2$ percent rather than the rate specified in those sections.

(2) In the case of an ''S corporation'' which is also a financial corporation, the rate of tax specified in paragraph (1) shall be increased by the excess of the rate imposed under Section 23183 over the rate imposed under Section 23151 and Section 23184 shall be applicable.

(c) An ''S corporation'' shall be subject to the minimum franchise tax imposed under Section 23153.

(d) (1) For purposes of subdivision (b), an ''S corporation'' shall be allowed a deduction under Section 24416 or 24416.1 (relating to net operating loss deductions), but only with respect to losses incurred during periods in which the corporation had in effect a valid election to be treated as an ''S corporation'' for purposes of this part.

(2) Section 1371(b) of the Internal Revenue Code, relating to denial of carryovers between ''C years'' and ''S years,'' shall apply for purposes of the tax imposed under subdivision (b), except as provided in paragraph (1).

(3) The provisions of this subdivision shall not affect the amount of any item of income or loss computed in accordance with the provisions of Section 1366 of the Internal Revenue Code, relating to passthrough items to shareholders.

(4) For purposes of subdivision (b) of Section 17276, relating to limitations on loss carryovers, losses passed through to shareholders of an ''S corporation,'' to the extent otherwise allowable without application of that subdivision, shall be fully included in the net operating loss of that shareholder and then that subdivision shall be applied to the entire net operating loss.

(e) For purposes of computing the taxes specified in subdivision (b), an ''S corporation'' shall be allowed a deduction from income for built-in gains and passive investment income for which a tax has been imposed under this part in accordance with the provisions of Section 1374 of the Internal Revenue Code, relating to tax imposed on certain built-in gains, or Section 1375 of the Internal Revenue Code, relating to tax imposed on passive investment income.

(f) For purposes of computing taxes imposed under this part, as provided in subdivision (b)—

(1) An ‘‘S corporation’’ shall compute its deductions for amortization and depreciation in accordance with the provisions of Part 10 (commencing with Section 17001) of Division 2.

(2) The provisions of Section 465 of the Internal Revenue Code, relating to limitation of deductions to the amount at risk, shall be applied in the same manner as in the case of an individual.

(3) (A) The provisions of Section 469 of the Internal Revenue Code, relating to limitations on passive activity losses and credits, shall be applied in the same manner as in the case of an individual. For purposes of the tax imposed under Section 23151 or 23501, as modified by this section, material participation shall be determined in accordance with Section 469(h) of the Internal Revenue Code, relating to certain closely held ‘‘C corporations’’ and personal service corporations.

(B) For purposes of this paragraph, the ‘‘adjusted gross income’’ of the ‘‘S corporation’’ shall be equal to its ‘‘net income,’’ as determined under Section 24341 with the modifications required by this subdivision, except that no deduction shall be allowed for contributions allowed by Section 24357.

(4) The exclusion provided under Section 18152.5 shall not be allowed to an ‘‘S corporation.’’

(g) The provisions of Section 1363(d) of the Internal Revenue Code, relating to recapture of LIFO benefits, shall be modified for purposes of this part to refer to Section 19102 in lieu of Section 6601 of the Internal Revenue Code.

SEC. 14. Section 1.5 of this bill incorporates amendments to Section 17054 of the Revenue and Taxation Code proposed by both this bill and SB 455. It shall only become operative if (1) both bills are enacted and become effective on or before January 1, 1998, (2) each bill amends Section 17054 of the Revenue and Taxation Code, and (3) this bill is enacted after SB 455, in which case Section 17054 of the Revenue and Taxation Code, as amended by SB 455, shall remain operative only until the operative date of this bill, at which time Section 1.5 of this bill shall become operative, and Section 1 of this bill shall not become operative.

SEC. 15. Section 2.5 of this bill incorporates amendments to Section 17062 of the Revenue and Taxation Code proposed by both this bill and SB 455. It shall only become operative if (1) both bills are enacted and become effective on or before January 1, 1998, (2) each bill amends Section 17062 of the Revenue and Taxation Code, and (3) this bill is enacted after SB 455, in which case Section 17062 of the Revenue and Taxation Code, as amended by SB 455, shall remain operative only until the operative date of this bill, at which time

Section 2.5 of this bill shall become operative, and Section 2 of this bill shall not become operative.

SEC. 16. Section 4.5 of this bill incorporates amendments to Section 17152 of the Revenue and Taxation Code proposed by both this bill and SB 5. It shall only become operative if (1) both bills are enacted and become effective on or before January 1, 1998, (2) each bill amends Section 17152 of the Revenue and Taxation Code, and (3) this bill is enacted after SB 5, in which case Section 17152 of the Revenue and Taxation Code, as amended by SB 5, shall remain operative only until the operative date of this bill, at which time Section 4.5 of this bill shall become operative, and Section 4 of this bill shall not become operative.

SEC. 17. This act provides for a tax levy within the meaning of Article IV of the Constitution and shall go into immediate effect, however, the provisions of this act shall be operative for taxable and income years beginning on or after January 1, 1998.

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